

An organization formed by several individuals to operate a health, recreational, and social club but whose predominant activity is the selling of services for profit to an unlimited number of so-called 'members,' who have no voice in the management of the club and whose only rights are to the use of the club's facilities upon the payment of specified fees, is not a tax-exempt social club within the meaning of section 501(c)(7) of the Internal Revenue Code of 1954.

Advice has been requested whether an organization formed by several individuals for the purpose of operating a health, recreational, and social club may be exempt from Federal income tax as a social club, within the meaning of section 501(c)(7) of the Internal Revenue Code of 1954, under the circumstances set forth below.

The instant organization was incorporated as a nonprofit membership corporation without capital stock. Its purposes are to operate a health, recreational and social club, including a clubhouse, restaurant, gymnasium, baths, and recreational facilities. Its bylaws provide for two classes of memberships, active and associate. The current membership consists of 25 active members and approximately 25,000 associate members. The active members have exclusive voting rights. The associate members have only the right to use the club facilities. The organization is managed and controlled by a board of directors elected from and by the active members. The officers of the organization are elected from among the board of directors. The board of directors functions as a membership committee, and any one of them may exercise the functions of the committee for the purpose of receiving applications for associate membership. In addition, any member of the membership committee may summarily revoke an associate membership at his discretion without assigning any reason therefor. Under the bylaws such revocation is effective immediately and without recourse.

The club leases its clubhouse which contains such facilities as Turkish and Russian baths, steam rooms, a roof solarium, swimming pools, a gymnasium, ball courts, a dormitory, club rooms, lounges, a restaurant, a barbershop, and a beauty salon. The club itself operates all these facilities with the exception of the restaurant and barbershop. These are leased to two of the active members under a concession arrangement calling for the payment to the club of a specified percentage of the gross receipts of the concession.

Five of the active members are full-time employees of the club and constitute a majority of the board of directors and of the membership committee. These five members have complete control over membership in the club and, under the articles of incorporation and the bylaws, have authority to fix and determine the use and disposition of club funds and, in general, to direct

all club business. The charges for the use of the various facilities and services provided by the club are fixed by and in the discretion of the directors. Each member also pays nominal yearly dues.

The club's income is derived from membership dues, rent from concessions, and fees for services provided in the operation of club facilities. Disbursements are made for salaries and wages, rent, supplies, equipment and miscellaneous operating expenses. Less than one-half of one percent of the income is attributable to active members and guests, the remainder being derived from associate members.

Section 501(c) of the Internal Revenue Code of 1954 describes certain organizations exempt from Federal income tax under section 501(a) and reads, in part, as follows:

(7) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder.

Section 1.501(c)(7)-1 of the Income Tax Regulations provides as follows:

(a) The exemption provided by section 501(a) for organizations described in section 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its net earnings inures to the benefit of any private shareholder. In general, this exemption extends to social and recreation clubs which are supported solely by membership fees, dues, and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

(b) A club which engages in business, such as making its social and recreational facilities available to the general public or by selling real estate, timber, or other products, is not organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, and is not exempt under section 501(a). Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes. However, an incidental sale of property will not deprive a club of its exemption.

On the basis of the information presented, it is concluded that the club in the instant case is operated in the personal interest of a few individuals; that social features are not a

material purpose of the club but are subordinate and merely incidental to the active furtherance of a predominant purpose to engage in the business of selling services for profit to an unlimited number of individuals termed 'associate members;' that 'associate' membership is not a true membership but is merely a guise under which virtually unlimited numbers of individuals may utilize the club facilities; and that income from associate members is in reality income from transactions with the general public.

Accordingly, it is held that the instant organization is not a social club as contemplated by the law and regulations and, consequently is not entitled to exemption from Federal income tax under section 501(a) of the Code as an organization described in section 501(c)(7) of the Code. See Rev. Rul. 58-589, below.